

NO. E-002/GR-89-865 DENYING PETITIONS FOR RECONSIDERATION AND
DENYING TRANSITIONAL RATE INCREASE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Commissioner
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In the Matter of the
Application of Northern States
Power Company for Authority to
Increase its Rates for
Electric Service in the State
of Minnesota

ISSUE DATE: November 26, 1990

DOCKET NO. E-002/GR-89-865

ORDER DENYING PETITIONS FOR
RECONSIDERATION AND DENYING
TRANSITIONAL RATE INCREASE

PROCEDURAL HISTORY

I. THE ORIGINAL ORDER

On August 28, 1990 the Commission issued its FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER in the above-entitled general rate case. In that Order the Commission denied Northern States Power Company's request for a general rate increase, declined to examine the Company's existing rate design, and ordered the Company to submit a plan for refunding interim rates.

II. PETITIONS FOR RECONSIDERATION AND OTHER POST-HEARING RELIEF

On September 14, 1990 the City of St. Paul, the Board of Water Commissioners of the City of St. Paul, the Municipal Pumpers Association, the Metalcasters of Minnesota, and the Suburban Rate Authority filed a joint petition for reconsideration of the August 28 Order. That petition alleged the Commission erred in declining to examine the rate design issues raised in the case.

On September 17, 1990 the Residential Utilities Division of the Office of the Attorney General filed a petition for clarification and/or reconsideration. That petition asked the Commission to clarify that its August 28 Order made no finding on required rate of return on equity, or, in the alternative, to make an explicit finding that the current required rate of return on equity is 11.4%.

On September 17, 1990 Northern States Power Company (NSP or the Company) filed a petition for reconsideration. That petition included a proposal that the Commission authorize the Company to

collect a "Transitional Rate Increase" while the Company, the Commission, and the intervenors worked together to resolve perceived problems in the Company's budgeting and accounting process. The Company claimed it could prove increased costs over those authorized in its last general rate case in seven discrete categories, justifying a Transitional Rate Increase of 39 million dollars. The Company proposed that the Transitional Rate Increase be collected subject to refund. In April of 1991 it would file actual 1990 financial data, which would be examined in light of the Company's actual capital structure and last authorized rate of return to determine whether any refund was due.

The Company also asked the Commission to extend the 10 day period for answering petitions for reconsideration, to allow intervenors sufficient time to analyze its proposal.

Under Minn. Stat. § 216B.27, subd. 4 (1990), any application for rehearing not granted within 20 days of filing is deemed denied. On September 26, 1990 the Commission issued an Order granting all petitions for purposes of tolling the 20-day period and affording them careful review. That Order also extended the deadline for responding to the Company's petition and solicited comments from all parties on the legal and procedural implications of the Company's request for a Transitional Rate Increase.

III. RESPONSIVE FILINGS

A. Responses to the Transitional Rate Increase Proposal

The Suburban Rate Authority, the City of St. Paul, the Board of Water Commissioners of the City of St. Paul, and the Municipal Pumpers Association (with the exception of the City of St. Cloud) supported the Company's request for a Transitional Rate Increase.

The Minnesota Senior Federation supported the request on condition that the Commission apply an 11.7% rate of return on equity, allocate the increase equally across rate classes, resolve the rate design issues in the case, award intervenor compensation as appropriate, and admonish the Company that it should see no urgency in filing a new general rate case. The North American Water Office supported the Transitional Rate Increase, on condition that it act as a bridge to a new rate design which no longer linked utility earnings with energy sales.

The Residential Utilities Division of the Office of the Attorney General (RUD-OAG), Champion International Corporation, Minnesota Energy Consumers, and North Star Steel Company opposed the Company's proposal.

The Department of Public Service (the Department) filed comments stating the Commission's original determination was correct, was supported in the record, and need not be reconsidered. The Department also offered its full cooperation, should the Commission choose to explore the Company's Transitional Rate Increase proposal in greater detail.

The City of St. Cloud, the Metalcasters of Minnesota, and Union Carbide Corporation took no position on the Transitional Rate Increase proposal.

B. Responses to the RUD-OAG's Petition, Withdrawal of Petition

The Department was the only party to reply to the RUD-OAG's petition for clarification and/or reconsideration. The Department contended that the Commission's August 28 Order was clear in declining to make any finding on current required rate of return on equity.

At oral argument the RUD-OAG withdrew its petition, stating it now understood the Order to make no finding on rate of return on equity.

C. Responses to Joint Petition

The Department and the RUD-OAG filed responses to the Joint Petition of the City of St. Paul, the Board of Water Commissioners of the City of St. Paul, the Municipal Pumpers Association, the Metalcasters of Minnesota, and the Suburban Rate Authority. The Department and the RUD-OAG stated it was within the Commission's discretion to decide or to defer the rate design issues in this case.

Champion International Corporation and the Minnesota Energy Consumers opposed the Joint Petition, stating the rate design issues in the case were inextricably intertwined with the financial issues the Commission had found could not be determined on the rate case record.

IV. PROCEEDINGS BEFORE THE COMMISSION

The petitions came before the Commission on November 8, 1990. All parties were granted opportunity for oral argument.

Upon review of the entire record of this proceeding, and having heard the arguments of counsel, the Commission makes the following Findings, Conclusions, and Order.

FINDINGS AND CONCLUSIONS

V. THE COMPANY'S REQUEST FOR RECONSIDERATION

In addition to its Transitional Rate Increase proposal, NSP filed a petition for reconsideration, claiming the Commission erred in finding the Company had not proved its proposed rate increase was just, reasonable, or necessary. For the most part, the petition reasserted the arguments of the Company at briefing and oral argument. Having duly considered the arguments in the petition, the Commission again concludes the rate case record does not provide a credible factual basis either for finding existing rates unjust and unreasonable or for setting just and reasonable rates. The Commission will therefore deny the Company's request that it reconsider and set rates on the basis of the existing record.

VI. THE COMPANY'S REQUEST FOR A TRANSITIONAL RATE INCREASE

A. The Company's Concerns

In the alternative, the Company requested a \$39 million Transitional Rate Increase to tide it over until its next rate case. The Company claimed that its costs had increased since its last rate case, that denying the entire rate increase was extreme and punitive, and that granting a modest increase was necessary to restore the investment community's faith in the Company and Minnesota regulation. The Commission disagrees.

It is not self-evident that cost increases since the last rate case necessitate a rate increase, and that the only issue is how large that increase should be. As several parties have noted, other costs may have decreased. More significantly, however, revenues as well as costs go into the earnings equation. Currently, the Company is enjoying sales revenues above those built into rates in the last rate case, weakening the causal link between increased costs and increased rates.

The Company argued that denying the entire rate increase was extreme, punitive, and out of proportion to the Commission's expressed concerns. The Commission disagrees. The Commission was forced to deny the rate increase because it had grave doubts about the accuracy, reliability, and predictive value of the test year budget data submitted by the Company. After weighing all the evidence, the Commission did not believe it more likely than not that NSP's existing rates were unjust and unreasonable. Neither did the Commission believe it more likely than not that the rate case record provided a trustworthy basis for setting new just and reasonable rates. Under these circumstances denying the

rate increase was neither extreme nor punitive; it was the only response proportional to the Commission's burden of proof concerns.

The Company also claimed that denying the entire rate increase would have untoward effects on the investment community's perception of the Company and the Minnesota regulatory environment, leading to an increase in the cost of capital. The Commission believes that the August 28 Order speaks for itself and will be properly interpreted by the financial community. The Commission has consistently granted and will continue to grant substantiated requests for rate increases by this and other Minnesota utilities. The Commission cannot grant unsubstantiated rate requests due to speculation about the reaction of the financial community.

B. Other Concerns

Besides the difficulties noted above, there are other obstacles to granting the Company's request for a Transitional Rate Increase.

1. After-the-Fact Ratemaking

The record developed over the course of this proceeding does not establish the Company's need for a \$39 million rate increase. If it did, the Commission would have ordered the increase instead of denying the entire rate request.

What the Company is asking the Commission to do is to allow it to collect 39 million dollars more than it has proved it needs, on the assumption that its actual 1990 revenue and expense figures will demonstrate it was indeed entitled to the money. These revenue and expense figures would be filed in April of 1991, when all parties would have full opportunity to examine and challenge them. This of course is the exact opposite of traditional ratemaking, where a utility's revenue requirement is calculated in advance on the basis of representative (test year) financial data.

There are sound reasons for traditional regulatory practice. Basing revenue requirements on financial data from a test year, a representative slice of the utility's normal operations, is intended to base rates on experience instead of conjecture. It is also intended to replace the fiscal discipline of the marketplace, which is absent for monopolies, with the fiscal discipline of prior determination of reasonable costs. Finally, it is intended to give utilities and ratepayers the assurance that their rates will not be changed retroactively. Only the most exigent circumstances would justify the radical departure

from traditional regulatory principles the Transitional Rate Increase represents. The Commission does not believe the Company has established such circumstances here.

2. Piecemeal Ratemaking

The Company's Transitional Rate Increase proposal also runs counter to established regulatory policy against piecemeal ratemaking. Ratemaking involves a host of complex and interrelated issues: necessary operating, maintenance, and capital expenses, reasonable cost of capital, appropriate capital structure, reasonable revenue projections, proper attribution of the costs of providing service, fair return on investment. Rates are set in general rate cases because they provide the comprehensive review of a utility's financial situation necessary for understanding these issues and how they affect one another.

Examining ratemaking issues in isolation produces a less accurate result than comprehensive review. This would be especially true of the Transitional Rate Increase proposal, where the Company asks the Commission to set rates on the basis of a limited number of expense items for which costs are claimed to have increased.

The Iowa Commission has summed up regulators' traditional view of piecemeal ratemaking as follows:

It is difficult to understand how the Commission can determine whether Iowa Power's rates are sufficient, just or reasonable by undertaking a limited examination of the two issues identified by Iowa Power. In order to make the determination mandated by Section 476.7, the Commission must look at the whole picture, not just isolated issues selected by the applicant. Moreover, there should be some finality to the Commission's determination of the reasonableness of rates. If a utility can come before the Commission with bits and pieces of rate cases, the Commission will be inundated with limited rate cases focusing upon just those issues that would support an increase, to the exclusion of issues that would support a rate decrease.

In re: Iowa Power & Light Co., Docket No. RPU-84-43, October 16, 1984, Order at 6.

The Commission does not believe the Company has established exigent circumstances justifying a departure from the sound regulatory practice of setting rates in fully developed general rate cases.

3. Legal and Procedural Difficulties

Granting a Transitional Rate Increase would also require the broadest possible reading of Minnesota regulatory statutes.

There are fundamental legal problems with ordering a \$39 million rate increase which is not substantiated by record evidence. In addition to constitutional concerns, Minnesota's general rate change statute and the Administrative Procedure Act require that rate change decisions and contested case decisions be based on substantial evidence viewing the record as a whole. Minn. Stat. § 216B.16, subds. 4 and 5; Minn. Stat. § 14.69 (1990). Here, that record evidence would not be fully developed until mid-1991, while the rates they are intended to support would have been in effect since January 1, 1990.

To accomplish this result, the rates would have to be construed as long term interim rates, although the statute anticipates that interim rates will be in effect only during the standard 10 month ratemaking period. Minn. Stat. § 216B.16, subd. 3 (1990). There would be further difficulties with justifying interim rates which are not based on any ongoing rate case, since the Company's \$121 million rate increase request would have to be deemed withdrawn or amended in such a thoroughgoing manner as to no longer be the same rate request.

Similarly, there are serious conceptual problems with having two general rate increases under review simultaneously -- one supported by the 1989 rate case-turned-Transitional-Rate-Increase record and one supported by the record in the new rate case the Company intends to file in January 1991.¹

The proper scope of the inquiry following the filing of the 1990 actual data is also unclear and would have to be developed as the proceeding unfolded. The Company proposed limiting the issues and applying the rate of return on equity approved in its last general rate case. If a party chose to assert its right to litigate rate of return, rate design, or similar issues, however, there is no commonly accepted legal basis on which to deny such a request.

4. Practical Concerns

Granting the Transitional Rate Increase and agreeing to review actual 1990 financial data in mid-1991 would also cause serious practical difficulties for all concerned.

¹ The Company has stated its intention to file a new general rate case as early in January 1991 as possible.

The Company plans to file a rate case in January 1991. All parties agree that it will require a great deal of effort on the part of the Company, interested intervenors, and Commission staff to ensure that the financial data filed in that case have the clear and substantial links with historical experience necessary to support a determination of just and reasonable rates. This will probably require revisions in the Company's budgeting processes, accounting procedures, and the format in which it presents ratemaking information.

Even a typical rate case is an arduous undertaking for a utility the size of NSP. NSP's 1991 rate case will not be typical and will make significant claims on the resources of all parties. To ask these parties to re-examine portions of the 1989 rate case during the 1991 case is unreasonable under any but the most compelling circumstances. Not only would it strain the resources of all parties; as a practical matter it could prevent the 1990 financial data from receiving the level of scrutiny they would deserve and would otherwise receive. The Commission finds that the Company has not established compelling circumstances justifying the extraordinary remedy of a Transitional Rate Increase.

VII. COMMISSION ACTION

The Transitional Rate Increase requested by the Company would be a truly extraordinary form of relief. It would require the Commission to abandon standard regulatory practice and make its way through a thicket of complicated legal, procedural, and policy issues. It would consume large amounts of resources from all parties, who have already devoted over twelve months to this case. It would proceed simultaneously with a new rate case, which would also make significant claims on the resources of all parties. Such extraordinary relief, entailing such extraordinary costs, should be granted only for lack of any reasonable alternative. The Commission finds that the Company has not established exigent circumstances compelling such relief and will therefore deny the Company's request for a Transitional Rate Increase.

VIII. THE PETITION ON RATE DESIGN

On reconsideration the City of St. Paul, the Board of Water Commissioners of the City of St. Paul, the Municipal Pumpers Association, the Metalcasters of Minnesota, and the Suburban Rate Authority asked the Commission to decide the rate design issues in this case. They argued that determining rate design would spare all parties the expense and inconvenience of relitigating that issue in the Company's 1991 rate case.

The Commission sympathizes with the parties, but continues to believe that the general rate case is the proper vehicle for any comprehensive re-examination of rate design issues. The Commission will therefore deny the joint petition.

ORDER

1. The joint petition for reconsideration filed by the City of St. Paul, the Board of Water Commissioners of the City of St. Paul, the Municipal Pumpers Association, the Metalcasters of Minnesota, and the Suburban Rate Authority is denied.
2. The petition for rehearing and the Transitional Rate Increase proposal filed by Northern States Power Company are denied.
3. Within 30 days of the date of this Order, the Company shall file for Commission review and approval a plan to refund to ratepayers interim rates collected under the December 29, 1989 ORDER SETTING INTERIM RATES. This refund shall include interest at the average prime rate for the collection period.
4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)